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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

v.

REPUBLIC COTTON MILLS.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION.

JOHN W. TOWNSEND,
1366 National Press Building,
Washington 4, D. C.,

J. CRAIG PEACOCK,
817 Munsey Building,
Washington 4, D. C.,
Counsel for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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The outstanding reason why this petition should be denied is that it falls short of presenting any substantial reason why it should be granted. In the first place it does not even purport to suggest that this case involves any considerations of general or public importance, or that the decision below would have any appreciable effect as a precedent. It has been nearly ten years since the processing tax was declared unconstitutional by this Court, and it

is notorious that the Government has long since succeeded only too well in forcing settlement of most of the resulting claims, large or small. The whole subject has become pretty much of a dead issue. Relatively speaking, only a handful of cases remain unclosed, and apparently few if any of them involve the same points as the present case.

Indeed, in spite of its length, the petition only makes two claims which, even on their face, could be conceived of as rising to the dignity of accepted reasons for the granting of certiorari by this Court. One is a half-hearted assertion at page 20 that the decision below that, in computing the statutory marginal presumption, the operations of Mill 3 should be considered separately and apart from those of Mills 1 in 2 "is in conflict, in principle" with the decisions of the Circuit Court of Appeals for the Sixth Circuit in the *Tennessee Consolidated Coal* and *Colonial Milling* cases. The other is a similar assertion at pages 25-26 of conflict with the decision of that same court in the recent *Snyder* case and with the admonitions of this Court in the *Dobson* case, combined with a claim that this Court should therefore exercise its supervisory powers. We will later comment on these points in the order named.

1. *As to Petitioner's Statement of the Questions Presented.*

Respondent does not agree with petitioner's statement of the questions presented by the record herein.

In the first question propounded by petitioner, the last clause reading "when all the mills processed the same taxable commodity—cotton" should be deleted and language similar to the following substituted:

> "when one of the mills in a separate plant with separate operating organization, processed a wholly distinct and more costly market classification, type and grade of cotton, not combined with the other grades processed by the other mills, thereby producing at a much higher cost distinctly different and specially styled cloths that

were sold through a separate sales mechanism, at much higher prices, to a different trade for different uses than the standard products of the other two mills".

The second and third questions propounded by respondent do not appear to require consideration at this time, for the decision below remanded the case to the Tax Court to consider the separate margins and weigh the evidence respecting the bearing of the burden of the tax, and to enter judgment according to the many decided cases, some of which were cited.

2. *As to Petitioner's Statement of the Facts.*

Certain facts bearing on the legal requirement for separate treatment of the two groups of mills are omitted in the petition, but are summarized in the opinion below, hereinafter quoted.

The limitations upon this brief do not permit pointing out all the inadequacies and inaccuracies in the petition and warning against the misconceptions to which they could so readily give rise. Before going further, however, there is one which should not be allowed to remain uncorrected. We refer to the recital about the margins in the long paragraph on page 7 of the petition, and especially to the introductory "If the margins are computed separately, * * *" in the sentence at the bottom of the page. Let no one think that this respondent's margins could be computed in any other way. The raw material, finished product, and operations of Mills 1 and 2, on the one hand, and of Mill 3, on the other hand, are so different in every respect that not even the Government has ever suggested that margins could be computed otherwise than by *first* computing all the factors separately for Mills 1 and 2 and for Mill 3. The respective figures for the various factors set forth in the paragraph on page 7 are nothing more than the combination of the corresponding separate figures for each mill (R. 7-8, 25-29, C. C. A. 5). By the same token the resulting presumptions

had to be separately rebutted, and from the very nature of things there was a difference in the kind of evidence relevant to the utterly different kind of operations and products of the several mills.

Petitioner also omits all reference to the findings of the Tax Court, respecting the so-called "tax-included clauses" in taxpayer-respondent's sales contracts, as follows (R. 10-11):

> "24. On and after August 1, 1933, phrases such as 'tax included', 'prices include processing tax', 'including processing tax', and the like were widely used by trade journals in connection with published Market quotations. The use of such phrases in that connection grew out of the fact that published quotations and prices on and after that date were all stated at flat, all-inclusive figures which were not subject to further adjustment on account of the processing tax, and also because it was highly desirable that it be made clear that published quotations were on this new basis as distinguished from methods of quotation which had been used prior to August 1, 1933.
>
> 25. These phrases were not generally used in petitioner's sales contracts. During the 20 months' tax period, petitioner entered into 596 sales contracts for Mills 1-2 and 487 sales contracts for Mill 3, a total of 1,083 contracts. In but 27 of those contracts with respect to Mills 1-2, and 27 of such contracts with respect to Mill 3, did any such phrase appear."

3. *The holding below that the operations of the two groups of mills must be separately considered was a ruling on a question of a law in full accord with the only reported decision in point, the two cases claimed by petitioner to be "in conflict, in principle" being not in conflict but actually tending to support the opinion below.*

The opinion of the Tax Court covers only two printed pages, one of which is devoted to a synopsis (quite inadequate) of the taxpayer-respondent's contentions (R. 24-25). Without citing a single case, without reference to the con-

trolling statutory provisions, and without any attempt to analyze the facts, that Court summarily disposed of the issues on the basis of combining the margins for Mill 3 with those of Mills 1 and 2.

The appellate court below, without attempting to weigh the evidence, concluded that such combination of margins and attempted solution of the problem was "erroneous as a matter of law", not being authorized by the statute, and being in direct conflict with the principle previously laid down in *Walker Tobacco Co.* v. *Commissioner*, 129 F. (2d) 464 (C. C. A. 6, 1942), which it quoted at length. The court below succintly summarized *the facts found by the Tax Court* and ruled as follows (C. C. A. 4, 6-7):

> "We think that the findings of fact made by the court require the conclusion that this method of computation was *erroneous as a matter of law.*
>
> The business conducted at the three mills was carried on by claimant as a single business venture. Mills 1 and 2, however, were operated as a single manufacturing unit with one superintendent and operating organization. Their production during the tax period was confined to five standard constructions of coarse cotton grade goods made from carded yarns produced from short staple cotton in the print cloth division of the textile industry. Mill 3, located three-fourths of a mile from Mills 1 to 2, was operated separately with its own superintendent and operating organization; it maintained separate accounts, except accounts receivable and payable; it sold its products through a different sales agency; its products lay in a division of the industry separate and apart from the manufacture of coarse goods and consisted in the manufacture of a constantly changing line of fine goods and specialties which were made from combed yarns produced from higher priced long staple cotton. The goods were composed at various times of a cloth of all-cotton, a cloth of mixed cotton and rayon, a cloth of mixed cotton and silk, or a cloth of all-rayon. During the tax period Mill 3 made over 50 different constructions in 500 or more styles.

None of the short staple cotton used by Mills 1 and 2 was mingled with the long staple cotton used by Mill 3 or vice versa. The manufacturing processes were separate and distinct and the two types of cotton were not combined in the finished products.

The two kinds of cotton were bought and manufactured at different costs and sold on different markets. During the tax period Mills 1 and 2 processed 8,249,683 pounds of short staple cotton at an average cost of 12.5¢ per pound while Mill 3 processed 2,114,547 pounds of long staple cotton at an average cost of 14.2¢ per pound; the average manufacturing cost per pound in Mills 1 and 2 was 12.39¢ while in Mill 3 it was 42.83¢; and the average sales value of the finished product derived from a pound of cotton in Mills 1 and 2 was 34.3¢ while in Mill 3 it was 65.8¢.

* * * * * * * * *

It is true that Sec. 907 (b) (4) provides that where the articles produced are the product of several commodities combined by the claimant during processing, the average margin shall be established with respect to such commodities as a group; but no such condition prevailed in the claimant's business. There was no combination of commodities in the goods produced in Mills 1 and 2 with those produced in Mill 3. On the contrary, as the court found, the manufacturing operations and selling operations were completely separate; the commodities used and the goods produced were of different qualities and values; and the market conditions were diverse. *The court seems to have relied entirely on the statutory presumption based on an average margin calculated in a manner that finds no support in the statute or in the facts of the case.*

We are in accord in this respect with the holding in *I. L. Walker Tobacco Co.* v. *Commissioner*, 6 Cir., 129 F. 2d 464, where a decision of the Tax Court was reversed wherein two basically different commodities, burley tobacco and scrap tobacco, were treated as one in calculating the statutory margins on goods produced by a manufacturer of smoking and chewing tobacco." (Italics supplied.)

Even cursory examination of the controlling statutory provisions proves that the court below was justified in so holding. Sec. 907(b), quoted in the appendix to the petition, requires a separately computed average margin computation for each "commodity" in respect of which a processing tax was collected. Sec. 913(c) defines "commodity" as a commodity of a type with respect to which a processing tax was imposed by the Agricultural Adjustment Act. Sec. 11 of the Agricultural Adjustment Act of May 12, 1933, C. 25, 48 Stat. 31 (U. S. C. A., Title 7, Sec. 611) provides as follows:

> "As used in this chapter, the term 'basic agricultural commodity' means wheat, rye, flax, barley, *cotton*, field corn, grain sorghums, hogs, cattle, rice, potatoes, tobacco, peanuts, sugar beets and sugar cane, and milk and its products, *and any regional or market classification, type, or grade thereof;* * * *." (Italics supplied.)

Sec. 907 (b) (4) provides:

> "(4) COMBINATION OF COMMODITIES.—Where, as for example, in the case of certain types of tobacco, the articles produced and sold by the claimant are the product of several commodities combined by him during processing, the average margins shall be established with respect to such commodities as a group, and not individually, in accordance with rules and regulations prescribed by the Commissioner, with the approval of the Secretary of the Treasury."

Thus it is clear that each "market classification, type, or grade" of cotton is to be treated as a separate commodity;* and further clear that such separate commodities may not be combined for purposes of the average margin computations except where "combined" during processing. This was the holding in the *Walker Tobacco Co.* case. Under Sec. 11 of the Agricultural Adjustment Act, *supra*, both tobacco and cotton are defined as commodities. The reference in

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*T. D. 5407 (Int. Rev. Bull. 1944—19—11862) similarly recognizes the different grades of cotton as distinct raw materials for income accounting purposes.

Sec. 907 (b) (4) to articles produced from several "types of tobacco" as an "example" is clearly equally applicable to articles produced from several "types of cotton". Unless the different types are combined in processing, Sec. 907 (b) (4) definitely contemplates that the average margin shall not be "established with respect to such commodities as a group". The Tax Court's conclusion (R. 25) that all three mills "must be treated as a single business entity" is wholly immaterial; obviously a "single business entity" might process a number of different commodities.

Indeed petitioner admits the decision below is in accord with the *Walker Tobacco* case, but urges (p. 21) that that case was not correctly decided. For purposes of this petition, however, the significant point is that two circuits (Fourth and Sixth), in well considered opinions, have reached like conclusions on the legal question involved. This in itself affords a sufficient ground for denial of the petition.

Petitioner's claim that the decision below "is in conflict, in principle", with the decisions of the Circuit Court of Appeals for the Sixth Circuit in *Tennessee Consolidated Coal Co.* v. *Commissioner*, 139 F. (2d) 47, and *Colonial Milling Co.* v. *Commissioner*, 132 F. (2d) 505, does not bear up under analysis.

At the outset it is to be noted that this Court denied certiorari in the *Colonial Milling* case (318 U. S. 780); and that both such cases were decided by the *same* circuit court that decided the *Walker Tobacco* case. In fact, the *Walker* case is cited in the *Colonial* opinion. So apparently the Sixth Circuit Court of Appeals was not itself aware of any inconsistency in its three decisions.

The *Tennessee Consolidated Coal* case related to unjust enrichment tax in respect of unconstitutional bituminous coal taxes not paid, and was governed by wholly different statutes from the present case. The unjust enrichment tax is an income tax based on all the taxpayer's operations for

a specified taxable year. Hence the decision cannot control a case like the present.

However, with respect to the *Tennessee Consolidated Coal* case, we need go no further than the quotation relied upon by the Government at page 20 of the petition, for it shows on its face that its requirement of the use of aggregate sales relates only to "computing the margin for tne base period and for the tax period", and there has never been the slightest question in the present case as to every sale of the 14,354,862 pounds of cotton processed in the base period and the 10,364,230 pounds processed in the tax period having been all included in the marginal computations (R. 7-8, 25-29). It is interesting to note, however, that in that case, just as here, a decision of the Tax Court in favor of the Government was reversed. Indeed, the appellate court went much further than here in categorically holding that the taxpayer's evidence "is convincing that the burden of the tax * * * was not shifted" and that the taxpayer's "proof was sufficient to rebut the presumption that the tax was shifted".

Nor does the holding in the *Colonial Milling* case that "consideration must be given to all transactions of the entire period as a whole" afford any conflict. That is exactly what was done in the instant case with respect to both the marginal computations and the rebuttal evidence. In that case the rebuttal evidence was of the same nature as that relied upon by the taxpayer in large part in the instant case, viz., a comparison of actually realized tax-period prices with the corresponding price level prevailing before the imposition of the tax. The ruling referred to at page 20 of the petition did not relate to the marginal computation. It related to the rebuttal evidence. The court, at 132 F. (2d) 509, definitely *conceded the relevancy of this type of evidence* but ruled against the taxpayer because the presumption "cannot be rebutted by presenting details favorable to the petitioner covering only part of the transactions for the periods." There is no conflict between that case and the instant case because here the rebuttal evidence covered *every sale* made by Mills 1 and 2 (R. 11-12).

4. *The decision below turned on questions of law; the circuit court did not attempt to usurp the functions of the Tax Court, but remanded the case for further proceedings in accordance with established legal principles; hence there has been no disregard of the rule of Dobson v. Commissioner, 320 U. S. 489.*

At pages 25-26 the petition calls for exercise by this Court of its supervisory powers because—it is alleged—the court below has usurped the functions of the Tax Court in weighing the evidence, choosing between conflicting inferences, and substituting its judgment of the facts for that of the Tax Court. Even a cursory examination of the record, however, readily shows that the court below has done nothing of the sort.

Snyder v. *Commissioner*, ... F. 2d ...., decided April 2, 1945 (another Sixth Circuit case) adds nothing to what was ruled by this Court in the *Dobson* case. This Court will well remember that in the latter case it ruled that the Tax Court's "decision, of course, must have 'warrant in the record' and a reasonable basis in the law" and that there must be "a rational basis for the conclusions approved by the administrative body" (320 U. S. 501). It needs only a brief analysis of the record to show that the instant decision of the Tax Court had neither; in fact, we have already shown that the Tax Court's holding that the operations of the three mills should be considered as a unit has no "warrant in the record" or "basis in the law". The court below therefore usurped no function of the administrative agency when it reversed and remanded the case with directions that all pertinent evidence should be weighed and considered and "that separate consideration should be given to this claim upon the remand in the light of the rule laid down in the statute and applied in numerous decisions" which it then proceeded to recite (C. C. A. 10). Incidentally, it will be noted the court below expressly refused to substitute its own judgment for that of the Tax Court, saying (C. C. A. 7-8):

"It was obviously not the purpose of the statute to confer upon the appellate courts the power to make an independent determination on the evidence as a whole and to substitute its judgment of the facts for that of the Board of Review or of the Tax Court which succeeded it. The power to make primary and ultimate findings of fact and to draw all proper inferences therefrom is lodged in the trial tribunal. Our function is limited to questions of law.

* * * * * * * * *

It will therefore become the duty of the Tax Court upon the remand to consider the claims of refund for taxes on the goods produced in Mills 1 and 2 separately from claims for refund on goods produced in Mill 3."

The petition fails to state that this case was on trial for seventeen days; that the Government devoted many days to introducing the evidence and exhibits which it cites at pages 23-24 of the petition and which it claims to be relevant; but that despite its request for findings of fact summarizing that evidence, the presiding officer declined to recommend such findings. It fails to state that under the detailed procedure expressly provided by Sec. 906 (d) and (e) of the Revenue Act of 1936, 49 Stat. 1748, and Rule 25 of the Processing Tax Board of Review, a copy of his recommended findings of fact was sent to each party by registered mail; that the Government had thirty days in which to file exceptions and proposed corrections; that, as specifically noted by the Tax Court in its memorandum, the Government "filed no such exceptions" (R. 2); and that the Tax Court "adopted, with slight modification, the findings recommended by the presiding officer" (C. C. A. 3). It was thus the administrative agency, and not the appellate court below, which decided that the voluminous evidence of which the Government makes so much at pages 22-25 of its petition was not relevant; and having thus, nearly four years ago, deliberately elected not to except to the recommended findings, all considerations of orderly procedure require that the Government be not permitted to again drag such evidence back into the case.

But that is only the negative side of the matter. The Tax Court did make forty-three paragraphs of comprehensive affirmative findings of basic facts (R. 2-23). The controlling issued argued to and decided by the court below was whether those findings did or did not support its ultimate conclusion against the present respondent.

Incidentally, it will be noted that that conclusion went all the way in holding affirmatively that the taxpayer respondent "did not bear the burden of any part of the amount it paid as tax with respect to its processing of cotton" (R. 23). But this case is not an all-or-none one. The $435,394.34 of unconstitutionally collected tax would permit as many as 43,539,435 possible decisions. In other words, the Tax Court held affirmatively that this respondent had shifted the burden of every one of those 43,539,434 cents—a thing which was obviously impossible on the face of the Tax Court's own actual findings of fact.

In coming now to those findings of fact, as to which the petition also is strangely silent, it is to be kept in mind that in the long line of representative circuit court of appeals cases cited at the end of the opinion below (C. C. A. 10), it had been held, at the joint instance of both the Government and taxpayers, that comparison of sales prices before and after imposition of the tax (as originally suggested by the Solicitor General himself at pages 138-139 and 105 of his brief to this Court in *Anniston Mfg. Co.* v. *Davis*, 301 U. S. 377) has become the most generally approved and widely used method of determining the extent to which the burden of the processing tax was borne or was shifted by the processor.

The ultimate issue before the court below was one of whether the Tax Court's own considered and comprehensive findings of fact constituted "warrant in the record" and "a rational basis" (as those terms are used in the *Dobson* case) for its conclusion, and we feel sure that when this Court reads those findings of fact (R. 2-23) with this in mind, it will fully agree that the court below did not ex-

ceed its proper functions and that there is no occasion to review or disturb its decision. Aside from the legal effect of the findings relating to the combination of the three mills (already discussed), we ask specifically what "rational basis for the conclusions approved by the administrative body" can possibly be found in its own considered findings of fact to the very opposite effect, that this respondent's products were sold on the open market in New York City (R. 5); that conditions culminating in July 1933 brought such a sharp increase in production and such a serious condition of overproduction in the textile industry that by August 1933 (when the processing tax was first imposed) supply began to exceed demand (R. 6); that that condition persisted with little abatement throughout the entire 20 month tax period (R. 6); that the oversupply became so serious that, in order to prevent demoralization of the price structure, N. R. A. on three different occasions executed orders limiting all productive textile machinery to 75% of the hours otherwise permitted by the Code (R. 6, and see the vigorous recitals and provisions of those orders the text of which is quoted at R. 76-78); that in spite of those preventive measures the nationwide unsold stocks of respondent's principal products increased from 22,000,000 yards at the beginning of the tax period to 121,000,000 yards at its close (R. 17); that on August 1, 1933, the effective date of the tax, and for the express purpose of shifting the tax, offering quotations were increased by adding the amount of the tax to the theretofore prevailing price (R. 10); that the volume of sales at those prices were relatively small, and that in no instance was there even a single sale of any product of Mills 1-2 at a price as high as its August 1, 1933, quotation (R. 10, 31-33); that within a month quotations had declined to a point as low as or lower than the July price level before addition of the tax (R. 10, 31-33); that on the actual sales of Mills 1-2 alone the total of such increases in the July level of prices was only $38,852.06, which was $307,731.31 less than the total tax on the cotton cov-

ered by those sales (R. 11-12); and that throughout ev month of the tax period respondent's other costs for cot manufacturing, and selling were nevertheless greater t in July, 1933 (R. 14, 27); that Mill 3 was run at a loss d ing the tax period (R. 18-19); that the comparison of Mill 3 margins, separately computed, is favorable to t payer-respondent (R. 8); etc.?

It is clear that the Tax Court predicated its decision the erroneously computed margins and ignored the mand of Sec. 907 (e) that consideration be given to "proof of actual extent to which the claimant shifted to others burden of the processing tax", and hence the court bel was correct in reversing such decision and remanding case for further consideration in accordance with est lished legal principles.

5. *Conclusion.*

For the foregoing reasons, the petition for a writ of c tiorari should be denied.

Respectfully submitted,

JOHN W. TOWNSEND,
1366 National Press Buildi
Washington 4, D. C.,

J. CRAIG PEACOCK,
817 Munsey Building,
Washington 4, D. C.,
Counsel for Respondent.

May, 1945.